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October 14, 2019

Via email to director@fasb.org

Mr. Shayne Kuhaneck, Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

**Re: Accounting for Convertible Instruments and Contracts in an Entity's Own Equity
(Subtopic 470-20 and 815-40) (File Reference No. 2019-730)**

Dear Mr. Kuhaneck:

We are pleased to provide comments on the Board's proposal to simplify the guidance for convertible instruments and contracts in an entity's own equity.

We support the Board's efforts to simplify the accounting requirements for such transactions. The history of standard-setting for instruments containing characteristics of both debt and equity has been one of the most vexing projects on the FASB's agenda for decades. Much of this is caused by complexity in the features that companies and their resource providers negotiate in the underlying contracts. This type of complexity cannot be avoided or solved by the Board.

With respect to establishing accounting principles for financing transactions, we also recognize that individual Board member views reached in good faith nonetheless conflict. For instance, some individuals believe certain obligations to deliver shares represent a liability; others may argue a liability cannot exist unless it requires an eventual transfer of cash or other assets.

These diverse perspectives, coupled with an expansive and evolving population of capital-raising transactions, has resulted in a patchwork of individual accounting standards over time. While they now reside in a single Codification, the underlying concepts are still internally inconsistent. Further, we routinely discuss the accounting requirements in this area of the literature with clients and their advisors, including investment bankers and other users. Those discussions confirm the feedback obtained in the Board's outreach that the accounting outcomes are often counterintuitive and unsatisfying.

If history is a guide, we are not optimistic that a new principles-based project to "solve" the accounting for debt and equity transactions would be viable. For these reasons, we agree with the Board's approach to significantly simplify the literature and to provide enhanced disclosures of the underlying instruments. We suspect additional standard-setting may be necessary as unintended outcomes of this proposal are identified in practice, but that is no different than any other accounting Topic. With time, we are optimistic an appropriate balance of a streamlined accounting regime with enhanced disclosures will become more readily understood and applied by stakeholders compared to current GAAP. This should have the positive effect of reducing the

frequency of accounting errors for convertible instruments and contracts in an entity's own equity.

In that context, we generally agree with the proposed changes, but think that additional implementation guidance on certain aspects of the proposed guidance would make it more operational. This will result in more consistent application, as elaborated in the Appendix to this letter. Among other things, we believe clarifying how to apply the proposed 'remote' threshold is key to making the improvements understandable. We also suggest a narrow-scope amendment to add a probability threshold to Topic 480 similar to the one proposed in ASC 815-40 because there are many warrants puttable upon a change of control that could similarly be classified in equity when the likelihood of such a transaction is remote. Lastly, we recommend providing a one-time election to apply the fair value option upon adoption of the new guidance for convertible instruments that were previously not eligible to be carried at fair value because part of the instrument was classified in equity.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Gautam Goswami at (312) 616-4631 or Adam Brown at (214) 665-0673.

Very truly yours,

Handwritten signature in blue ink that reads "BDO USA, LLP".

BDO USA, LLP

Appendix

Question 1: Should convertible instruments be accounted for as a single unit of account, except in circumstances in which the conversion features are required to be bifurcated by guidance in Topic 815? Please explain why or why not. Under this simplification, would any specific information about convertible instruments be missing in order to understand an entity's financial position and financial performance? If so, please explain what information would be missing and how that information is used.

We generally agree with the proposed elimination of certain guidance such that two models will remain (the traditional convertible debt model with a single unit of account under Subtopic 470-20 and the embedded derivative model under Subtopic 815-15). We expect this will reduce the cost and complexity of preparing and auditing financial statements, while still retaining decision-useful information.

We note convertible instruments generally have a lower stated interest rate than nonconvertible instruments and are sometimes issued and/or recognized at a premium. This may occur when a convertible instrument is recorded at fair value in a new basis event such as a business combination. Since a substantial premium will no longer be separately recognized, we are unclear whether the amortization of such premiums may result in net interest income, instead of expense; e.g., if the contractual interest expense is lower than the premium amortized. Considering the wide variety and complex nature of financial instruments and the structuring consistent with capital needs, we urge the Board to clarify the accounting in such circumstances.

Question 2: Do the disclosure amendments in this proposed Update for convertible debt instruments in paragraphs 470-20-50-1A through 50-11 and for convertible preferred stock in paragraphs 505-10-50-12 through 50-18 provide decision-useful information? Should any of these disclosures be required for every annual and interim period for which a statement of financial position and a statement of financial performance are presented? Should any other disclosures for convertible instruments be required? Please explain why or why not.

We agree that the proposed incremental disclosures will provide users with useful information regarding terms and features of convertible instruments. This is particularly important in the event that a feature is not required to be bifurcated or accounted for as a liability. To achieve consistency with the accounting model (i.e., potential changes in accounting that are triggered by the occurrence of specified events), we suggest requiring the full set of disclosures (470-20-50-1A through 50-11 and 505-10-50-12 through 50-18) on an annual basis; and requiring only disclosure of changes in events or accounting conclusions (e.g., reassessments) in interim periods. For completeness, we also suggest that disclosures related to standard antidilution provisions be included in the amended disclosures.

Proposed paragraph 505-10-50-18 indicates that an entity would disclose information about derivative transactions entered into in connection with the issuance of convertible preferred stock regardless of whether such derivative transactions are accounted for as assets, liabilities, or equity instruments. We request that the Board clarify the scope of the "derivative transactions" contemplated by this disclosure, especially as instruments recognized as derivatives under Topic 815 are generally not classified as equity instruments. While paragraph 470-20-50-11

provides an example of a derivative transaction entered into in connection with the issuance of a convertible debt (the example is the purchase of call options that are expected to substantially offset changes in the fair value or the dilutive effect of the conversion option), it is unclear whether the disclosure is limited to instruments recognized as a derivative or also includes instruments for which the derivative scope exception is met. Further, that example refers to debt and not preferred stock. We also observe proposed paragraph 815-40-50-2 indicates that entities are not required to provide disclosures required by Section 505-10-50 for equity-classified contracts other than those described under the provisions of Subtopic 815-40. This appears to be contradictory to the requirements in proposed paragraph 505-10-50-18 noted above and we suggest that the Basis for Conclusions (Basis) clarify the interaction between them.

Further, as proposed, it is unclear whether paragraphs 470-20-50-1G and 505-10-50-17 are intended to require entities to provide disclosures under both Topics 815 and 470 to the bifurcated item. Our understanding is the disclosure under Subtopics 470-20 and 505-10 are only for the host instrument after bifurcation of the embedded feature, since ASC 815-15-25-54 indicates the host instrument and the derivative are separate units of account under GAAP.¹ Consequently, we recommend the Board clarify this point. We also recommend that the Board clarify whether the disclosure in 470-20-50-1G applies to any debt host, regardless of the nature of the bifurcated derivative (e.g., a bifurcated conversion or redemption option).

Question 3: Should remote settlement features be disregarded for purposes of determining the classification of a contract in an entity's own equity (for both indexation and settlement)? Is remote an operable threshold? Please explain why or why not.

We generally agree that remote settlement features should be disregarded for purposes of determining the classification of a contract in an entity's own equity to reduce form-over-substance-based accounting conclusions.

However, we believe the guidance would be more operable if the Board were to provide implementation guidance in the form of factors, indicators, and/or examples about how to assess whether an event is considered remote. For example, it is often difficult to assess the probability of occurrence of events that are outside the entity's control, such as whether a change in control will occur or whether an initial public offering (IPO) will be declared effective. Further, even if an IPO is declared effective, it may be difficult to assess whether it would meet contractual thresholds required for an instrument to settle (e.g., IPO with minimum proceeds above a certain pre-specified amount). Similarly, we suggest that the Board indicate how long-term instruments would be assessed considering that an entity cannot generally forecast more than a few years with any reasonable certainty, consistent with the reversionary period after management's reasonable and supportable forecast under CECL. We believe that providing additional indicators or examples would improve operability and result in a more consistent application of the requirements. Otherwise, the likely result will be that various stakeholders will "second guess" significant accounting and audit judgments.

The Board might also consider a narrow-scope amendment to add a similar probability threshold to Topic 480, especially paragraph 480-10-25-8. We expect that the addition of a probability

¹ "If an embedded derivative is separated from its host contract, the host contract shall be accounted for based on GAAP applicable to instruments of that type that do not contain embedded derivatives."

threshold within Subtopic 815-40 without a similar threshold in Topic 480 will create inconsistency and likely confusion among preparers and users. For example, warrants that are puttable upon a remote change in control event, which in theory may be outside the issuer's control but practically may be unlikely to occur without the Board of Directors' consent (e.g., due to uneconomic poison pill provisions), are often liability-classified and measured at fair value each period under Topic 480. The impact of the ED's simplification of the ASC 815-40 model may be significantly undermined without amending ASC 480.

Question 4: Should a requirement to settle a contract in registered shares not affect the classification of a contract in the entity's own equity? Please explain why or why not.

We agree such a requirement should not affect classification. In particular, we agree with the Basis for Conclusions (BC75) that there is often a disagreement between lawyers and accountants about conclusions and we do not believe that economically similar outcomes (for example, cashless exercise versus gross settlement) should be treated differently. In addition, in certain scenarios, such as when an entity does not have an effective registration statement and is experiencing financial difficulties, gross settlement may be an uneconomic settlement alternative, particularly when a cashless exercise option exists.

We also agree that determining whether an entity has sufficient authorized and unissued shares and whether a contract contains an explicit share limit is a straight forward exercise for entities in most cases. However, it is unclear why the Board has not proposed applying the same "remote" threshold for the other retained conditions in paragraph 815-40-25-10 to determine the likelihood of cash settlement due to a potential shortfall in unissued shares. We recommend providing such a threshold or explaining in the Basis why it would be inappropriate to do so.

Question 5: Should a requirement to post collateral not affect the classification of a contract in an entity's own equity? Please explain why or why not.

We agree such a requirement should not affect classification and agree with the Basis for Conclusions in this regard.

Further, we suggest that the Basis discuss why the retained cash-settled top-off or make-whole provision is considered a settlement provision, instead of a penalty payment.

Question 6: Should the hierarchy of a counterparty's rights or shareholder rights not affect the classification of a contract in an entity's own equity? Please explain why or why not.

We agree such a requirement should not affect classification. We note that different classes of equity often include different rights.

Question 7: Are the proposed amendments about reassessment of the derivatives scope exception operable? Should reassessment of the derivatives scope exception occur only upon a reassessment event (as defined in paragraph 815-40-35-8)? If not, should the reassessment be performed more frequently even if a reassessment event has not occurred, for example, on an annual basis? If performed annually, should the likelihood threshold be remote or should a different threshold be applied? Please explain your rationale for each of the answers provided.

We generally agree reassessment should be required only upon the occurrence of a specified event as described in paragraph 815-40-35-8. We considered whether it was more important to adhere to a concept that the accounting should be adjusted any time a change in probability occurs (e.g., an event becomes possible or probable), but believe that the practicality of the proposed approach, supported by appropriate disclosures, is preferable. Further, we are unclear why expiration of a settlement feature should necessitate a reassessment, as proposed, given that all the features in the instrument were assessed at inception over the term of the instrument.

We understand the Board intends this reassessment to apply to the scope exception, not to whether an instrument or embedded feature meets the definition of a derivative under Topic 815. However, we have concerns about the interaction of the proposed guidance and the requirement to reassess whether an instrument or embedded feature meets the definition of a derivative, and request that the Board clarify how different events should be (re)assessed. For example, net settlement is generally an ongoing evaluation such that an embedded conversion option might first qualify as a derivative upon an entity completing a successful IPO. In such circumstances, we believe the scope exception would need to be reassessed for the conversion option, regardless of whether any of the triggering events in paragraph 35-8 have occurred. In addition, during a current assessment of the conversion option in that scenario, it may be inconsistent to ignore indicators that a previously-assessed redemption event is no longer remote.

To illustrate, certain debt instruments of a public entity may be both convertible into common shares and additionally include a make-whole (redemption) feature settleable in cash upon a change in control. If the conversion and the make whole redemption features are assessed as separate units of account, it may be internally inconsistent to arrive at different conclusions for the conversion feature (e.g., if change in control per the current assessment is determined to be more than remote of occurrence) versus continuing with the earlier determination of that same change in control event being remote for the make-whole redemption feature.

Separately, we recommend including within paragraph 815-40-35-8 a requirement to reassess upon contract modification and also clarify whether that reassessment would be limited only to the modified terms or result in a complete reassessment, including whether the other unchanged terms continue to be remote of occurring. In this context, we note paragraph 35-8A states that reassessment occurs "only" upon the conditions listed in paragraph 35-8.

Lastly, we recommend that the Board consider whether a reassessment of an existing instrument be required if a similar instrument is subsequently issued and assessed, so that the conclusions are uniform for both the newly issued and existing instrument.

Question 8: Do the proposed disclosure amendments for contracts in an entity's own equity in paragraph 815-40-50-5(f) through (g) provide decision-useful information? Please explain why or why not. Should any other disclosures for contracts in an entity's own equity be required? Please explain which disclosures should be required and why.

We agree with the proposed disclosure amendments. As noted in our response to question #7, we recognize the importance of thorough qualitative and quantitative disclosures, particularly given that continual reassessment of the derivatives scope exception will no longer be required. As

noted earlier, we also suggest that standard antidilution provisions be included in the amended disclosures.

Question 9: Under current guidance in Topic 825, fair value disclosures are required for financial instruments that are classified as liabilities but are not required for financial instruments that are classified as equity. Should new fair value disclosures be considered for public business entities for all equity-classified instruments, including those outside the scope of the proposed amendments (such as employee stock options)? If yes, how would you use that information? If yes, which equity-classified instruments should the disclosures be required for?

We do not support adding new fair value disclosure requirements for equity-classified instruments. This would introduce procedures and analyses above and beyond those required for recognition and measurement of such instruments and would create unnecessary complexity and cost.

Question 10: Should diluted EPS for all convertible instruments be calculated using the if-converted method of diluted EPS? Is the revision to the if-converted method in paragraph 260-10-45-40(b) operable? Please explain why or why not.

We agree the if-converted method should be required to compute diluted EPS for all convertible instruments and believe that the revisions are operable. However, to mitigate confusion and reconcile to the examples in paragraphs 260-10-55-84 through 55-84B, we recommend the Board acknowledge in the Basis that for certain instruments, application of the if-converted method may be similar to the treasury stock method. We note that currently it is relatively rare to apply the treasury stock method for convertible instruments, therefore we do not expect significant change in practice resulting from the amendments.

Question 11: For a contract that may be settled in either cash or shares (except for certain share-based payment arrangements that are classified as liabilities), should an entity presume (and not be allowed to overcome the presumption) share settlement when calculating diluted EPS? Please explain why or why not.

We agree with eliminating the ability to rebut the presumption of share settlement and believe that is consistent with the principle that diluted EPS should reflect maximum potential dilution. However, we do not support retaining a difference between this presumption for convertible instruments and stock-based compensation instruments. We suggest removing paragraph 45-45A and the following proposed language in paragraph 45-45: "unless the share-based payment arrangement is classified as a liability because of the requirements in paragraph 718-10-25-15 (see paragraph 260-10-45-45A for guidance for those instruments)." We note that this would not impact the classification guidance in Topic 718 and would create consistency in approach for diluted EPS across various instruments.

Question 12: Should the Board consider a project about the effect of antidilutive instruments on the diluted EPS calculation (for example, the effect of call options used to offset the potential dilution from convertible instruments)? Should any other EPS improvements be considered? If yes, please provide details.

We are not aware of current practice issues related to anti-dilutive instruments. Further, we are supportive of presenting maximum potential dilution for diluted EPS.

Question 13: Should the proposed amendments that affect classification, recognition, and measurement be applied on a modified retrospective basis, with an option for full retrospective application? Do you agree with the Board's proposed transition expedient? Please explain why or why not.

We agree with the proposed transition guidance and transition expedient. However, we note that the early application option in paragraph 815-40-65-1c is limited to "any convertible security that includes a down round feature" if an entity has not yet adopted ASU 2017-11. We recommend eliminating the references to ASU 2017-11 to provide an unqualified choice to early adopt.

We also recommend the Board consider providing a one-time election to apply the fair value option upon adoption of the proposed Accounting Standards Update for convertible instruments that were previously precluded from the fair value option due to being classified in shareholders' equity in whole or in part. We believe that some entities may find this option preferable as it avoids the complexities associated with assessing an equity-linked instrument for classification or embedded derivatives for bifurcation. However, unlike equity-linked instruments, we agree that instruments issued as legal form equity (e.g., common shares, preferred shares that are not mandatorily redeemable, or member units) should continue to be ineligible for the fair value option.

Question 14: Should the proposed amendments to EPS be applied as of the initial date of adoption for the transition from treasury stock method to if-converted method and applied retrospectively for instruments that may be settled in cash or shares? Please explain why or why not.

As noted in our response to question #10, we do not expect a significant change in method or outcomes, so we recommend the same transition requirements for all aspects of the EPS amendments. If the Board proceeds to require two different approaches, we request further rationale in the Basis. We also request the Board clarify whether retrospective application is only for existing instruments at adoption date or includes instruments that were outstanding in the retrospective period but not at adoption date.

Question 15: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? Please explain your response.

We believe one year would provide enough time for public business entities to implement the changes proposed in this exposure draft. We also recommend a delayed effective date for other entities. That is, the effective date for those entities should be at least one year following the effective date for public entities, consistent with transition provisions in other new ASUs. Under the final amendments, judgment will be involved in applying the remote threshold and significant guidance (cash conversion and beneficial conversion feature) will be superseded. Further, deferred tax balances will need to be recalculated. For these reasons, the Board may also consider whether the "effective date philosophy" recently proposed for broad projects would be

appropriate. Regardless, we recommend providing all entities with an option to early adopt the final amendments.

Question 16: The proposed amendments would affect all entities that issue convertible instruments and/or contracts in an entity's own equity. Are there any specific private company considerations, in the context of applying the Private Company Decision Making Framework, that the Board should be aware of?

We believe the proposed amendments achieve simplification and should apply broadly to all entities. As indicated in our cover letter, we believe that further clarity with respect to applying the remote threshold is important to making the improvements operational.

To enhance understanding of the transition requirements for all entities, including private companies, we recommend that the explanatory transition table provided in BC 117 instead be included in the main body of the amendments. Further, to raise awareness, we suggest noting in the Basis that there may be deferred tax effects associated with adoption, e.g., the elimination of accounting for beneficial conversion feature may impact previously recorded temporary differences.

Question 17: The proposed amendments would supersede various areas of guidance (such as the guidance on certain accounting models for convertible instruments). Do you expect that superseding that guidance will result in any unintended consequences? For example, is there guidance that is currently analogized in practice to account for transactions for which there is no explicit guidance under current GAAP? Please explain what those unintended consequences are and potential solutions, if applicable.

We note that ASC 480-10-S99-3A requires an instrument to be classified outside of permanent equity if it is redeemable upon the occurrence of an event that is not solely within the control of the issuer. It is unclear to us whether and how the proposed amendments to the derivatives scope exception should be considered in that assessment. For example, without such clarification, it is unclear whether a remote possibility that an investor who was issued warrants in a public offering but may insist on gross share settlement even in circumstances where there is no effective registration statement would preclude permanent equity classification, as that may require a net cash settlement. Similarly, it is unclear whether a remote threshold should be applied to other events or circumstances that are not solely within the issuer's control in determining classification as temporary or permanent. As such, we recommend coordinating with the SEC staff on this point.

We note that determining the appropriate unit of account will continue to be key in applying the amendments. There may be diversity on whether some of the instruments in paragraph 470-20-05-8 contain features that should be considered redemption features instead of conversion features, which will depend on the contractual terms. Whether those features should be accounted as one unit of account or separately may inform that assessment. We acknowledge that unit of account guidance is beyond the scope of this proposal. However, we recommend stating in the Overview and Background section (470-20-05) that entities should first consider whether any such features require bifurcation under ASC 815-15. While this concept is reflected in 470-20-15-2B (as proposed), we believe it is important to highlight the sequence of the assessment at the beginning of Topic 470 for users of the Codification.

Other Matters

In the paragraph BC 95, we suggest that the Board acknowledge a private company warrant having a cashless exercise provision would generally meet the net settlement criterion to be considered a derivative.

With respect to paragraph 260-10-55-34 (as proposed), we believe the Basis for Conclusions should also explain the reason for the changes to the year-to-date computation of diluted EPS, which will now refer to paragraph 260-10-55-3. This could represent a change in practice for some entities.

Lastly, BC 81 suggests that indexation is continually reassessed, similar to whether an instrument is eligible for equity classification. Since an indexation assessment depends strictly on the terms of the instrument that are known and analyzed at inception, we do not believe practitioners continually revisit the indexation test each period.